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# PROMOTING PRIVATE SECTOR FOR DEVELOPMENT: THE RISE OF BLENDED FINANCE IN EU AID ARCHITECTURE<sup>1</sup>

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## Abstract

Since 2007, the EU has been pushing for blended finance to mobilise private sector for development. This is a novel and controversial financial policy coinciding with the growing debate on “beyond aid” and the emergence of new financial tools and actors that are actively engaged with the global development agenda. Since the 1960s, grants and concessional loans (or more simply, aid) have been the dominant type of development finance provided by the EU, together with debt relief and the costs of technical assistance. But aid is no longer the main source of development finance for most developing countries, now replaced by private financial flows: foreign direct investment (FDI), remittances and philanthropy. Business-led economic growth is at the core of the 2030 global development agenda seen as the primary driver of investments, jobs creation and production of goods and services. In consequence, the EU is moving to combine aid with other public and private resources (blended finance) to catalyse and leverage additional funds from the private sector. This paper will critically analyse the emergence and evolution of EU blended finance to support the private sector to deliver the Sustainable Development Goals (SDGs) by 2030 and the potential implications for EU development cooperation.

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## INTRODUCTION

The EU is a leading and active actor in the international aid architecture. Through the European Commission (EC) and its EU Delegations in 136 countries it provides not only direct donor support to recipient partner countries (in the form of grants, loans and equities) but also coordinates the global development policies of its 28 Member States (OECD, 2012). The EU international development cooperation is particularly important due to the strong financial resources it involves and the potential positive impact it can have if well implemented and managed by the bloc. In 2017 the total aid provided by the EU (EC and Member States) reached 75,7 billion EURO, a decrease of 2.4% or 1.9 billion EURO from 2016 when the EU's collective ODA reached its highest level ever. The EU and its Member States continue to be the world's largest ODA donor providing around 57% of the total ODA reported for the year by the members of the Development Assistance Committee (DAC) of the OECD (OECD, 2017). But aid is no longer the main development finance recourse for most developing countries, now replaced by private financial flows: foreign direct investment (FDI), remittances and philanthropy (OECD, 2018). While a decreasing number of low income countries (LICs) are still highly depended on aid, lower middle-income countries (LMICs) and upper middle-income countries (UMICs) are more dependent on remittances and FDI, respectively. Within this context, the EU launched in 2011 its new development cooperation policy, the so-called *Agenda for Change* that coincided with the Busan High Level Forum on Aid Effectiveness in South Korea. This European agenda emphasises two main pillars for EU development policy: (1) the promotion of human rights, democracy, rule of law and good governance and; (2) the promotion of inclusive and sustainable growth.

One of the major shifts evident in the *Agenda for Change* is precisely the attempt to differentiate development partnerships leading to significant changes in the relationships between the EU and upper-middle income (UMICs) and high-income countries (HICs). Krätke (2013) states that this new approach – differentiation – will affect countries such as Brazil, China, India, Mexico, Thailand or Indonesia since they will stop receiving bilateral

assistance. They might, nevertheless, receive funding through other EU thematic programmes and other instruments, such as the *blended finance* facilities. The selection is to be based in four criteria: country needs, country capacity, country commitments and performance, and potential EU impact. The EC Communication “Improving EU support to developing countries in mobilising Financing for Development” (2012) made clear that “donors can take action that supports or creates leverage for other development finance” and that “ODA is more important to the poorest countries who have limited access to other sources”. The Communication emphasised also a “more strategically and effectively” usage of grants for “leveraging public and private sector resources”. In this paper, we will focus on the second pillar and how it is linked with the capacity of the EU in pursuing its strategic interests by engaging and attracting private sector investments through a new and rapidly growing popular financial instrument: *blended finance*.

## 1. THE EU AGENDA FOR CHANGE, PRIVATE SECTOR ENGAGEMENT & BLENDED FINANCE

The EU *Agenda for Change* has marked a shift in the way the EU regards its development cooperation policy by attracting the private sector as a partner in the promotion of inclusive and sustainable growth in partner countries. This is to be done by resorting to resources available in its two main financial instruments for international development cooperation: the European Development Fund (EDF) and the Development Cooperation Instrument (DCI) that together account for the biggest share of EU funding for global development policies. For the EU’s Multiannual Financial Framework of 2014-2020, EDF and DCI totals around 50 billion EURO (EC, 2013).<sup>2</sup> The *Agenda for Change* (EC, 2011) clearly

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<sup>2</sup> The EDF is was established in 1957 by the Treaty of Rome and launched two years later. It is the EU’s main instrument for offering ODA to the ACP countries (African, Caribbean and Pacific). The EDF is an EC-controlled and voluntarily fund based on member states’ contribution that is decided among them all. Because it does not follow the rules applied to the EU budget but its own financial rules, the EDF is not under the European Parliament (EP) oversight and faces lower levels of accountability (Gavas, 2012). There has been growing calls from the EP to gain oversight rights over EDF, but this decision has been delayed until 2020 (EURODAD, 2013). The DCI is one of the EC’s development cooperation financing mechanisms aimed at Asian, African and Latin American countries.

states its goals and orientation when it comes to the EC future approach to private sector as a partner to implement its international development cooperation goals:

“...crucial to developing countries’ success is attracting and retaining substantial private domestic and foreign investment and improving infrastructure. *The EU should develop new ways of engaging with the private sector, notably with a view to leveraging private sector activity and risk-sharing mechanisms to catalyse public-private partnerships and private investment (italics added).*”

“In selected sectors and countries, *a higher percentage of EU development resources should be deployed through existing or new financial instruments, such as blending grants and loans and other risk-sharing mechanisms, in order to leverage further resources and thus increase impact (italics added).*”

This focus on engaging the private sector coincided with one of the main outcomes of the Busan Forum in 2011. As Mawdsley (2014) states, the forum became the global stage for the emergence of the private sector as an important partner in the Global Partnership for Effective Development Cooperation (GPEDC). Throughout the days of the forum, the conversations stressed how the private sector was increasingly regarded as the right player to efficiently deliver development solutions after the poor results achieved by the OECD-led Paris Aid Effectiveness Agenda in 2005. Following the Agenda for Change and the Busan Forum, the EC released in 2014 its Communication entitled “A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries” (EC, 2014). This Communication reinforces and clarifies how the EC intends to work with the private sector and places the EC as playing “a stronger role as facilitator of companies’ own engagement for development, for instance by encouraging responsible investment in developing countries, or sustainable supply chains and production patterns”. It also adds that the EC wants to set the example to “to inspire efforts by EU Member States, financing institutions and other development partners of the EU”.

## 2. EC'S CRITERIA TO SUPPORT PRIVATE SECTOR INVESTMENTS

The Communication introduces a set of 6 criteria that is to guide the EC decisions to directly support private sector investments: (1) measurable development impact, i.e., the private sector investment has to contribute in a cost-effective way for development goals such as job creation, green growth or poverty reduction and this approach needs to be monitored, evaluated and based on results; (2) additionality, i.e., public support when the company does not have the capacity to pursue with the investment as long as the public support will not crowd out the private sector or substitute other private financing; (3) neutrality, i.e., public support should be given when there are market failures, through an open, transparent and fair call system and it should be temporary in nature with a clearly defined exit strategy; (4) shared interest and co-financing, i.e., risks, costs and rewards of a joint partnership have to be shared fairly between the public and private sectors and be based on cost-effectiveness and mutual accountability for results; (5) demonstration effect, i.e., a publicly-supported investment needs to show that it has the capacity to attract other private sector actors for replication and scale-up of development results and finally; (6) adherence to social, environmental and fiscal standards, i.e., private sector companies receiving public support need to show that are respecting environmental, social and fiscal standards, including respect for human and indigenous rights, decent work, good corporate governance and sector-specific norms (EC, 2014).

### 2.1 THE RISE OF EU BLENDED FINANCE (2007-2013)

The main EU financial instrument to support private sector investments that emerged in the past 10 years is the so-called *blended finance* that basically involves the combination of grant aid sourced from official ODA with other private or public sources of finance, such as loans, risk capital and/or equity. The grant aid is expected to leverage the additional non-grant financing and reduce exposure to risk and deliver needs that are failing to be addressed particularly in sectors crucial for economic growth such as infrastructure, energy, industries or job-generating projects. Grant aid can take different formats with the most commonly practiced

being investment grants and interest rate subsidies (reduction of initial investments and overall project costs for the partner country), technical assistance (support for quality, efficiency and sustainability of project), risk capital (equity or quasi-equity to attract additional finance) or guarantees (reduce risk to unlock finance for development) (EC, 2018\*).

The engagement with the private sector via *blended finance* was highlighted in the EC Communication “Improving EU support to developing countries in mobilising Financing for Development: “Engaging the private sector in development financing is another innovative way of mobilising new funds (...) the EU should also use its grants more strategically and effectively for leveraging public and private sector resources” (EC, 2014). While blending grants and loans is a new format for the EC this is not an uncommon approach in international development finance (Bilal and Krätke, 2013). European development finance institutions (EDFIs) like the Agence Française de Développement (AFD), the European Investment Bank (EIB) or the German development bank KfW have already been using these financial mechanisms on a regular basis to increase their lending and support to private companies. DFIs tend to be mostly public-owned institutions and they focus their lending, at either commercial rates or concessional terms, on private sector investing in developing countries. Additionally, through their export credit agencies (ECAS), EU governments are also known to have supported for a long-time ODA grants blended with commercial loans (EURODAD, 2013).

EU *blended finance* facilities began to take shape during the EU’s 2007-2013 Multiannual Financial Framework. EU *blended finance* is channelled through facilities managed by either the EC or the EIB. While the EC manages eight such facilities (covering all regions of EU external cooperation), the EIB manages two other facilities (Investment Facility for Africa, Caribbean and Pacific Countries and Investment Facility for Overseas Countries and Territories). The following table shows the 8 investment facilities under management of the EC and the funding they received for the period 2007-2013:



Table 1: Key EU Regional Investment Facilities for Blending Loans and Grants

Loan and Grant Blending Mechanism	Date launched	Grant funding	Approx. # projects since 2007	Full participatory financiers (observers)
<b>EU-Africa Infrastructure Trust Fund (ITF):</b> 47 African ACP countries	2007	€459 million from 10th EDF + €108 mln from MS / DFIs	57	AECID, AfDB, AFD, BIO, EIB, FINNFUND, KfW, LuxDev, OoEB, PIDG, SIMEST, SOFID
<b>Neighbourhood Investment Facility (NIF):</b> 16 countries eligible for the European Neighbourhood and Partnership Instrument (ENPI)	2008	€767 mln 2007-13 from EU budget (ENPI) + €77 mln from MS / DFIs	79	AECID, AFD, CEB, EBRD, EIB, KfW, NIB, OeEB, SIMEST, SOFID
<b>Western Balkan Investment Framework (WBIF):</b> 6 countries	2009	€218 mln from EU budget + €80 mln from MS / DFIs	137	CEB, EBRD, EIB, KfW, WB
<b>Latin America Investment Facility (LAIF):</b> 18 countries	2010	€192 mln 2009-13 from EU budget	20	AECID, AFD, EIB, KfW, NIB, OeEB, SIMEST, SOFID (CABEI, CAF, IADB)
<b>Investment Facility for Central Asia (IFCA):</b> 5 countries	2010	€65 mln 2011-13 from the EU budget	8	AECID, AFD, EBRD, EIB, KfW, NIB, OeEB, SIMEST, SOFID (ADB, WB)
<b>Asia Investment Facility (AIF)</b>	2012	€30 mln 2011-13 from EU budget	4	AECID, AFD, EBRD, EIB, KfW, NIB, OeEB, SIMEST, SOFID (ADB)
<b>Caribbean Investment Facility (CIF):</b> 15 Caribbean ACP countries	2012	€40 mln from EU budget		AECID, AFD, CDB, EIB, IADB, KfW, NIB, OeEB, SIMEST, SOFID (CABEI)
<b>Investment Facility for the Pacific (IFP)</b>	2012	€10 mln from EU budget		AECID, AFD, EIB, KfW, NIB, OeEB, SIMEST, SOFID (ADB)
<b>Total</b>		<b>€ 2.046 billion</b>	<b>&gt;300</b>	

Source: adapted from Ferrer, and Behrens, 2011, supplemented with data found in European Parliament, 2013. Blank fields mean unavailable or unknown data.

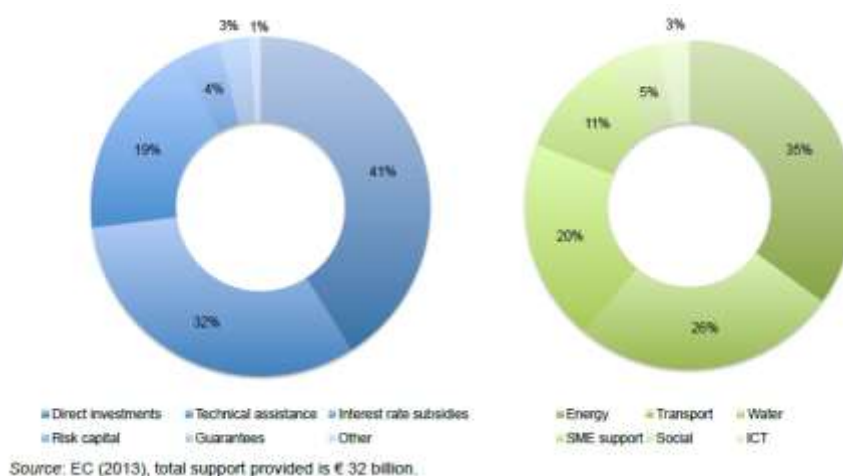
Source: Bilal and Krätke, 2013

As shown in the table, the grant share of EU *blended finance* comes from the EU's budget for international development cooperation (DCI or EDF) and from Member States' development finance institutions (DFIs). Since the establishment of the first EU blending facility in 2007 (EU-Africa Infrastructure Fund that became the African Investment Facility in 2015), grants channelled through blending facilities reached by the end of 2013, 2.046 billion EURO. This is a very small percentage of overall EU ODA estimated in comparison with the 16.9 billion EURO allocated to the DCI during the period 2007-2013 (Gavas, 2010) and most of these blending operations were used to leverage loans aimed at the public sector in developing countries (Bilal and Krätke, 2013).

There are three main types of grants in the blending facilities: direct investment, technical assistance and interest rate subsidies. These were the most commonly used

instruments during the 2007-2013 multiannual financial framework to account for 93% of the total amount of grants approved by the EU blending facilities managed by the EC (EURODAD, 2013). A 2013 report produced by EURODAD, the European Network on Debt and Development, that brings together 47 civil society organisations from 20 European countries, evaluating the EU blending facilities revealed that there was no specific rule determining the size of the grant as it varied in accordance with the type of project, the type of instrument, the assessment of the financiers and the opinion of the EC staff (EURODAD, 2013). For the period 2007-2013, EU blended finance focused on supporting infrastructure investments, particularly in the transport and energy sectors with these two sectors covering 60% of the total amount of approved grants (see figure 1):

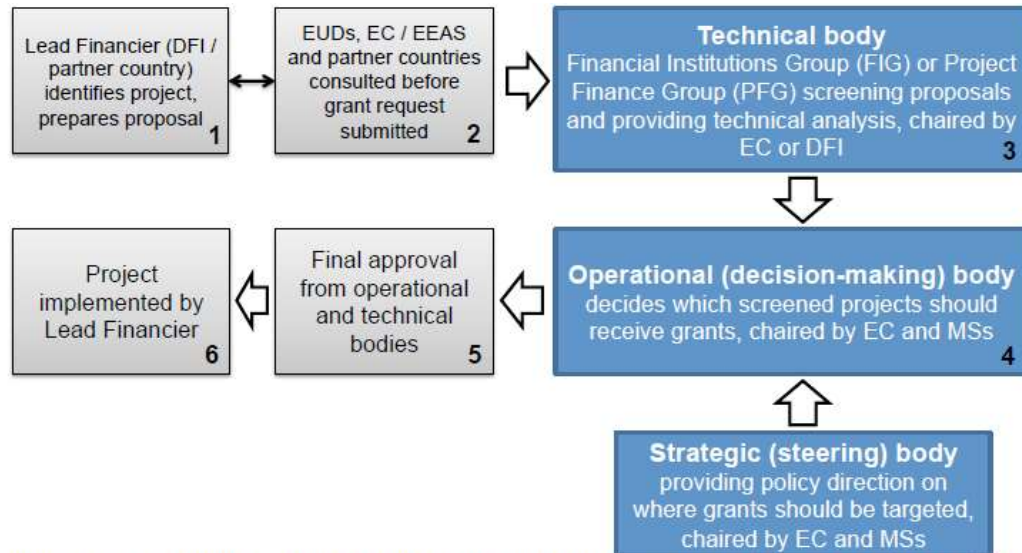
**Fig. 1: Grant Support Provided through EU Blending Mechanisms 2007-2012 (type and sector)**



**Source: Bilal and Krätke, 2013**

EU blending operations and mechanisms usually followed a three-tiered governance structure. First, EU eligible development financial institutions (with the partner country) identify the project with the partner country, prepare and submit the proposals as the Lead Financier to the technical body. Second, the projects are approved based on detailed and relevant assessment criteria. The projects are screened against the objectives of EU external policy through an internal review and consultation process with the EC and the European External Action Service- EEAS (see figure 2):

Fig. 2: Basic Governance Structure of Blending Mechanisms and Project Lifecycle



Source: own design based on DIE, ECDPM, FRIDE and ODI, 2011 and project lifecycle identified in the following presentation: <http://www.qzs.si/pripone/37263/Evropski%20mehanizmi%20za%20podporo%20qospodarstvu.pdf>

Source: Bilal and Krätke, 2013

The governance structure for each facility is composed of a strategic board, an operational board and a financier institutions group. These bodies are composed of EC staff – from DGDEVCO (DEVCO C3 Unit – Investment and Innovative Financing) in six of them – Member States representatives and financial institutions (in some cases as observers) which meets to evaluate and decide on the submitted proposals. The EC holds the hand in the approval of projects due to the leading and convening role of DGDEVCO. Partners in the beneficiary country can be public, private or mixed. For EURODAD (2013), there is a very low level of ownership by the countries that are expected to benefit from the subsidised loan despite the EU's earlier agreement to respect and support ownership as part of the Paris Agenda on Aid Effectiveness. At the level of the operational board, beneficiary countries are not involved in the decision over the projects that will receive grants and their institutions are not allowed to lead the implementation of the projects. While beneficiary countries are represented at the strategic board that set the goals of the facilities, since the latter are expected to follow the wider EU policy it is hard to say to what extent this policy does in fact fulfil the interests of the beneficiary countries (see Table 2):

Fig. 3: EU Blending Facilities: Governance Structure

	Facilities		
Body	NIF/LAIF/IFCA/AIF/CIF/IFP(a)	WBIF(b)	ITF(c)
<b>Strategic board</b> Sets the goals of the facilities to guarantee they are in line with the wider EU policy	<b>Members</b> EC, MS, beneficiary countries and financial institutions (observers) <b>Co-chairs:</b> EC and EEAS	<b>Members(d):</b> EC, EBRD member countries, if they are donors, beneficiary countries and financial institutions <b>Co-chairs:</b> EC and one donor	<b>Members:</b> EC, MS, beneficiary countries and financial institutions (observers) <b>Co-chairs:</b> EC and AU
<b>Operational board</b> Decides which projects should receive grants and monitors the development of the project pipeline.	<b>Members:</b> EC, EEAS and MS, financial institutions (observers) <b>Chair:</b> EC		<b>Members:</b> EC, donors, MS which are not yet donors and the EIB (the last two as observers) <b>Chair:</b> EC (but can rotate)
<b>Financiers group</b> Selects projects based on guidelines and financial sustainability	<b>Members:</b> EC and financial institutions <b>Chair:</b> EC	<b>Members:</b> EC and financial institutions <b>Co-chairs:</b> EC and financial institutions	<b>Members:</b> Project financiers nominated by each donor <b>Chair:</b> No formal, typically the EIB

(a) Directorate-General for Development and Cooperation is in charge.

(b) Directorate-General for Enlargement is in charge.

(c) The EIB acts as the fund manager and is in charge of providing the secretariat.

(d) In the case of the WBIF, this body is called Steering Committee.

Source: Annual reports and public documents

Source: EURODAD, 2013

An important feature of the EU *blended finance* facilities is the relevant role that is given to EU DFIs in the financial implementation of the projects. The EURODAD report (2013) shows that four DFIs - the EIB, AFD, KfW and the European Bank for Reconstruction and Development (EBRD) – have been responsible for intermediating 91% of the grants approved by the blending facilities managed by DEVCO.

## 2.2. ASSESSING EU PRIVATE SECTOR ENGAGEMENT AND EVOLUTION OF BLENDED FINANCE

The EC policy statement for the private sector, subscribed by the highest EU body - the Council of the European Union - in December 2014, has, however, not led to consensus. For Bruce Byers et al (2014) at ECDPM, while this is an initiative that updates the EU development cooperation policy vis-à-vis other leading donors like the UK (Mawdsley, 2014), it also raises several challenges. First, access to finance is not the only issue influencing private sector development investments. Another major obstacle is access to information to identify projects/sectors with development impact and profitability potential as well as ideal local partners. Second, the initiative will need to align with developing countries' own economic development strategies (industrial transformation, agricultural policies, infrastructure projects, etc). Yet, the interests of the EU private sector might not reflect or even challenge these strategies. Third, unlike some EU member states, EU in-country delegations do not seem to have the necessary skills and staff to work with the private sector as expected and stated by the Communication. Finally, the Communication is, as put by Byiers et al, "remarkable a-political": "the space for success or failure of any private sector development intervention, by the EU or others, ultimately depends on domestic politics and policies of developing countries: this determines what reforms are carried out, what standards are upheld and how contracts are awarded" (Byiers et al, 2014).

European organised civil society is also not without criticisms towards this new approach, accusing it to benefit EU big businesses rather than SMEs in beneficiary countries. AidWatch 2012, a report from CONCORD, the EU Development NGOs Platform, that monitors and make recommendations on EU aid effectiveness, argues that: "few credible actions are envisaged to regulate private investment effectively in order to improve its social returns and overall development effectiveness, however, so the new focus on the private sector is likely to result in EU investors benefiting from EU aid, rather than poor countries benefitting from private investment" (CONCORD, 2012). Action Aid, EURODAD and Oxfam International in a joint statement (2014), while acknowledging the important role played by the private sector as a creator of jobs and in achieving economic growth also stress the limitations of its role. It states that "it is questionable whether EU companies should be

supported through development policy given the need for additional development resources and the risk of increasing aid ties to the delivery of European goods and services. When considering using scarce overseas aid money to leverage private finance and to support private sector activities, the EU should learn from mistakes in the past from the experience of other donors such as the World Bank”. Additionally, the joint statement states that the way the criteria is presented at the Communication makes difficult the job to identify how the EC is planning to put them into practice or make the private sector comply with them. It calls for an implementation of the Communication that respects the internationally agreed principles such as the Busan Development Effectiveness Principles, the UN Guiding Principles on Business and Human Rights and the Voluntary Guidelines on the Responsible Governance of Tenure. The three organisations defend that it is most important for the EU to support small local businesses than big foreign multinationals and to “help support states’ capabilities to regulate and expand free publicly provided health care and education, on the basis of increased domestic resources, and in conformity with the International Covenant on Economic, Social and Cultural Rights”.

Additionally, *blended finance* raises the issue of development impact. For Bilal and Krätke (2013) EU blended finance can promote the mobilisation of additional resources to support development, by “opening up and incentivising entrance to new or otherwise risky markets for private sector actors”, and “introducing efficiency gains to EU development assistance”. But these authors also stress that “it remains unclear to what extent projects funded through blending have a development impact” and that it might risk “providing insufficient attention to transparency and accountability” due to “ill-defined monitoring and evaluation methods”. Furthermore, they emphasise “the debt risks for developing countries of increasing lending” since blending facilities primarily fund projects undertaken by developing country governments and it can be seen as an “inefficient way of incentivizing private investment and addressing risk”. EURODAD (2013) shares some of the risk analysis raised by Bilal and Krätke by showing how EU blending facilities have been unsuccessful in attracting private sector investment as the non-grant additional funding for EU blending facilities have been essentially provided by government-owned institutions, or as EURODAD puts it, “there has been no real “leverage” of additional resources, only a pooling of existing funding”. EURODAD argues that “there is little evidence available



regarding how the EU-level blending facilities implement or even contribute to achieving the internationally agreed objectives of the aid effectiveness agenda, particularly the key principles of ownership, alignment, harmonization and mutual accountability”.

At the level of the other EU bodies, the new policy appears to be slowly embraced, even if not consensual on how it should be operationalised. In 2014, the European Court of Auditors (ECA) after assessing EU *blended finance* stated that “blending the regional investment facility grants with loans from financial institutions to support EU external policies has been generally effective” (ECA, 2014). In its special report entitled “The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies”, ECA, nonetheless, raises the fact that the approval process set by the EC “was not thorough, and the decisions to award the grants, at a particular level, were frequently not convincingly evidenced”. It added also that: “Guidance on what criteria the Commission should use in its decision-making was also lacking. Once grants were approved, the advance disbursements were unnecessarily high. The Commission’s monitoring did not ensure that the added value of grants was achieved in all cases”. In 2015, the EP adopted a resolution on Financing for Development recognising that public aid will be insufficient to address investment needs of developing countries and calling for blended finance and public-private partnerships (PPPs) “as a means to enhance the impact of development assistance, to attract private finance and to support local businesses” (2015). The resolution stressed, however, “that blended finance must not replace state responsibility for delivering on social needs and should be aligned with national development objectives and with development effectiveness principles”. In April 2016, a EP resolution on the private sector and development went further by pushing for a stronger role of the DFIs, namely EIB, in this new policy by calling for: “an expansion of the current EIB external lending mandate, in order to increase its role in achieving sustainable development and, in particular, to take a more active part in the new private sector strategy, through blending, co-financing of projects and local private sector developments” (EP, 2016).

By the end of the EU 2014-2020 Multiannual Financial Framework, the EC-only development cooperation budget is expected to total almost 97 billion EURO. Out of this amount, 19.6 billion EURO have been targeted at the DCI and another 30.5 billion EURO

at the EDF (EC, 2013). Despite the ongoing debate on whether the new EU policy can offer potential development impact, the figures for EU *blended finance* are expected to increase considerably and the launching of a new initiative in 2017, the EU External Investment Plan (EIP), seems to offer that evidence. The EIP aims at encouraging investment in EU partner countries in Africa and in the EU Neighbourhood area (EC, 2018\*\*\*). According to the EC, the EIP has three parts: (1) the European Fund for Sustainable Development (EFSD) that includes a financial guarantee and blending facilities to leverage public and private investment; (2) technical assistance to help investors and businesses design bankable projects and partner countries to improve their regulatory environments; and (3) dialogue with partner countries to build rules of the game more supportive of business and investment (EC, 2018\*\*\*). The EFSD budget is composed of two existent blended facilities – the Africa Investment Platform (AIP, formerly AfIF - Africa Investment Facility) and the Neighbourhood Investment Platform (NIP, formerly NIF - Neighbourhood Investment Facility) totalling 2.6 billion EURO and the EFSD guarantee of 1.5 billion EURO. With this budget of 4.1 billion EURO, the EFSD is expected to leverage investments of 44 billion EURO in Africa and the European Neighbourhood. This compares with the 3.4 billion EURO in EU grants provided by all EU *blended finance* facilities to all regions covered by EU development policy between 2007-2017 that unlocked investments of 57.3 billion EURO (EC, 2018\*\*). This “private turn of development finance” as put by Elisa Van Waeyenberge (2015) is seems to be a long-term approach.



## CONCLUSION: EXPLAINING EU NEW DEVELOPMENT POLICY - THE IMPACT OF A CHANGING GLOBAL AID ORDER

EU's embrace of *blended finance* in support of private sector for development already regarded as a sign of the growing financialization process of EU's development policies (Bonizzi et al, 2015). While this seems to be the trend, the explanation tends to fall into a debate between the role of public versus private actors in delivering the best outcomes in terms of development impact when (Van Waeyenberge, 2015) failing to look at how shifting and complex dynamics in the global aid arena might also influencing the redefinition of EU development policy goals and tools to achieve such goals. The Beyond Aid (BA) debate focuses on how “four partially overlapping” features are reshaping the dynamics of the global aid arena: first, the proliferation and diversification of actors (states, line ministers, global funds, cities, private sector, foundations or non-governmental organisations); second, additional and new sources to finance development (foreign direct investment or FDI, remittances, national tax revenues, public-private partnerships, blended finance, international financial transaction taxes, carbon emission certificates and airline taxes); third, new national or international regulatory approaches on trade, migration, climate or development coherence and finally, growing knowledge sharing (new farming techniques, better public financial capabilities or climate change technology transfer) (Janus et al, 2015, Gore, 2013, Smith, 2011).

Within the BA debate, it is hard not to reflect on how the “rise of the South” (OECD, 2010, UNDP, 2013, Hackenesh and Janus, 2013) driven by a growing South-South cooperation (SSC) and Asian donors have pushed rich donors to rethink the geopolitical and economic impact of their development policies. The SSC challenge to the previously hegemonic OECD-DAC hegemonic narrative and practice is based on an alternative ideological framework supported by plentiful material resources (Mawdsley, 2017). First, SSC favours blended finance over aid, economic growth over poverty reduction, national interests over global interests and support for public-private partnerships in infrastructure and production development. This is particularly evident in the aid policies of Asian partners

such as China (Jiang, 2016) or South Korea (Kim and Gray, 2016). These donors are basically essentially replicating the same development paradigm models set earlier by Japan before the latter reluctantly adapted its own targets, norms and practices to an OECD-DAC member (Carvalho, 2015). Subjected to criticisms for this approach, Japan reluctantly tried to adapt to the OECD-DAC membership rules in terms of expected targets, norms and practices. Second, SSC has supported these policies with rapid increase of different types of development finance resources beyond official aid flows for the past decade (Benn, 2017, Greenhill and Prizzon, 2013). This has helped South-South trade relations, particularly within and between Asia and other developing countries, to rapidly expand and contribute for to the economic “rise of the South” and to account for a significant share of world trade (UNCTAD, 2013 and 2015). A good example is provided by the case of China and its development finance facilities aimed both at Africa and Latin America (Carvalho, 2015, Jiang, 2016). Recently, China has launched two new multilateral development finance institutions (DFIs) showing the country’s willingness to increase development finance to developing countries: the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) or BRICS development bank. China provides grants, concessionary loans, debt relief, technical assistance, training, tariff exemptions, infrastructure investments, equipment or other capital goods (Jiang, 2016). Since the 2000s, this approach seems to have strongly benefited China, allowing it to become the top trading partner for many African and Latin American countries.

Related with this “rise of the South”, since 2000, development finance flows once dominated by official aid flows provided by rich donors or international multilateral development banks such as the World Bank have slowly stopped being a primary financial source for developing countries, except for low-income and fragile countries. Aid has been replaced by private financial flows such as FDI, remittances and philanthropy (OECD, 2018, Ray, 2009). For example, between 2000 and 2014, FDI grew from 78 billion US\$ to 402 billion US\$ while aid from OECD-DAC countries increased from 80.4 billion US\$ to 132 billion US\$, respectively. The slowing erosion of the importance of aid vis-à-vis other development finance resources together with the need to reconsider the regulation of future of aid budgets following the 2008 crisis has led rich donors to re-assess the current aid

architecture based on specific normative goals, policy frameworks supported by spending targets.

Since the 1960s, rich donors, due to their global economic leadership, have led the narrative and practice within the global development arena by setting specific normative goals and policy frameworks supported by spending targets (Fuhrer, 1994, Hynes, 2013). Grouped around OECD-DAC, rich donors have embraced global poverty fighting as the prominent goal in their development policies. The OECD-DAC's aid order has depended on voluntary but binding agreements set by consensus, rather than centralised enforcement. The rise of the private sector as a crucial partner to implement development policies provided the OECD-DAC the opportunity to start discussing the modernization of aid definition to potentially include the financial support that their members' DFIs already provide to the private sector in developing countries (Kharas et al, 2014, DI, 2017, Tew, 2017). However, much of this financial support is typically non-concessional, or at a low level of concessionality and would not usually be counted as ODA under the current rules. In face of the new consensus on the need to back up private sector in developing countries, DAC agreed in 2016 that financial instruments currently under usage by donor members to support private sector would be counted as ODA. These Private Sector Instruments or PSIs include loans, guarantees and equity investments. In draft proposals, DAC has already proposed either an institutional approach or an instrument approach through which donor members could count their PSIs as ODA. With the institutional approach, donors could count their capital funds provided to the DFI as ODA. The instrumental approach would offer donors the opportunity to count the grant element percentage of the investments made by the DFIs in developing countries as ODA. The DAC communiqué from October 2017 stated there was still no agreement at this point on the proposed PSIs rules but it appears that DAC members will be allowed to report PSIs as ODA (Tew, 2017).

Meanwhile, since 2014, the DAC has been working with the international community in a new statistical standard, TOSSD or Total Official Support for Sustainable Development, to align its statistical system with today's richer development finance landscape (OECD, 2016). The OECD defines TOSSD as including "all officially-supported resource flows to promote sustainable development in developing countries and to support development

enablers or address global challenges at regional or global levels”. The OECD adds that “TOSSD will measure “external” finance – resources provided from beyond the borders of the countries receiving it. It will cover all officially-supported resource flows regardless of financial instrument used or level of concessionality, or whether they are delivered through bilateral or multilateral channels. TOSSD will enable the international community to monitor resources supporting the SDGs above and beyond ODA, including private resources that are mobilised through official means. It will also track international support for development enablers and global challenges – heretofore “invisible” in global development finance statistics” (OECD, 2016). The ODA measure will remain to be applicable only to OECD-DAC members and other aid providers that follow the organisation’s specific definition and rules while TOSSD will complement it (OECD, 2017).

Finally, since December 2009 with the Treaty of Lisbon, EU development policy is now part of the EU’s areas of external action and development cooperation is clearly described in Articles 208 to 211 (Mah, 2015). The treaty created the new post of High Representative (HR) for Foreign Affairs and Security Policy (who is simultaneously vice-president of the European Commission) and the European External Action Service (EEAS) to provide more strength and consistency to the EU global activities. At the same time, within the European Commission, a new Directorate General for Development and Cooperation EuropeAid (or DG DEVCO) was set in January 2011 following the merger of parts of the former Directorate General for Development and EuropeAid Cooperation Office. As it stands, EEAS and DG DEVCO are both in charge of the programming for three European development aid funds: the geographical components of the Development Cooperation Instrument (DCI), the European Development Fund (EDF) and the European Neighbourhood and Partnership Instrument (ENPI). EEAS leads the first three phases of the programming: (1) country allocation; (2) strategic reports for each country and region; (3) national and regional indicative programmes. These are then submitted to the High Representative (HR) for Foreign Affairs and Security Policy and to Development Commissioner to be approved by the College of Commissioners. Once approved, the programmes, DG DEVCO becomes the sole responsible for the next and last two phases of the programming: (4) annual action plans and (5) implementation of the programmes. While the Development Commissioner is regarded as holding full authority of the joint

programming cycle, development policy is now subjected to the strategic interests of EU external policy. In 2016, the EU HR for Foreign Affairs and Security Policy, Federica Mogherini, launched the EU Global Strategy with five main external priorities: (1) the security of the Union; (2) state and societal resilience in the EU Neighbourhood and Africa; (3) an integrated approach to conflicts; (4) cooperative regional orders and (5) global governance for the 21<sup>st</sup> century (EEAS, 2016). A year later, the EIP, the new blended finance instrument emerges as a potential tool to “tackle the roots causes of irregular migration and forced displacement” from the EU neighbourhood that have in the past years strongly influenced European politics and electoral outcomes.

The EC was the first main traditional donor to formally introduce *blended finance* in its development policy in 2011. Since then, this financial instrument has risen to the top of the global development policy exemplified by the latest 2018 OECD Report entitled “Making Blended Finance Work for the Sustainable Development Goals.

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